

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

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Refer Reply To:

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Date: AUGUST 01, 2013

RE:

Legend

Settlor

Trust 1

Trust 2

Trust 3

Child 1

Child 2

Child 3

Date 1

Date 2

Year

Foundation

Independent

Trustee

Dear :

This letter responds to your authorized representative's letter dated February 3, 2013, requesting gift, estate, and generation-skipping transfer (GST) tax rulings with respect to the proposed modifications of three trusts.

The facts and representations submitted are summarized as follows:

On Date 1, Settlor created and funded two irrevocable trusts, Trust 1 and Trust 2. Currently, Child 1 is the primary beneficiary of Trust 1 and Child 2 is the primary beneficiary of Trust 2. On Date 2, Settlor created and funded another irrevocable trust,

Trust 3. Currently, Child 3 is the primary beneficiary of Trust 3. Dates 1 and 2 are prior to September 25, 1985. Independent Trustee, a corporate trustee, is the trustee of all three trusts.

Each trust is identical, except for beneficiaries. Each trust provides that, during the life of a child (Child 1, Child 2, or Child 3), the trustees may distribute so much of the net income to the child as the trustees, in their discretion, deem necessary or advisable. Upon the death of a child, the trustees, in their discretion, may pay so much of the net income in equal shares, *per stirpes*, to the then living issue of a child for their health, happiness, maintenance, education, welfare, or comfort. In addition, the trustees at any time may pay so much of the principal to a child and his issue as the trustees, in their discretion, deem necessary or advisable; provided, that the purpose for which payment is made justifies, in the sole discretion of the trustees, a reduction in the principal of the trust estate.

Each trust will terminate on the first to occur of (i) 20 years after the death of the last survivor of the child and those of his siblings who were living when the trust was created, or (ii) the death of the last survivor of the child and his issue. On the termination of the trust, the accumulated income and principal will be distributed to the issue of the child, *per stirpes*. If none of the child's issue is then living, the trust principal and accumulated income is to be distributed to the other issue or trusts for the other issue of the Settlor. If all issue of Settlor are deceased, the undistributed income and principal will be distributed to Foundation.

Each trust also provides that in no event shall any of the trust estate vest in the Settlor, the Settlor's parents, or any individual trustee named in their individual capacity.

Each trust originally required that all investment decisions be made jointly by the Independent Trustee and the individual trustee. In Year, each trust was modified to provide that: (i) the Independent Trustee would have exclusive power regarding distribution decisions, (ii) the individual trustee (Investment Trustee) would have exclusive power regarding investment decisions, (iii) the primary beneficiary will have the power to remove and replace the Investment Trustee and the Independent Trustee, and (iv) any successor Independent Trustee cannot be related or subordinate to the primary beneficiary within the meaning of § 672(c) of the Internal Revenue Code.

The Independent Trustee proposes to add an individual distribution trustee (Distribution Trustee) for the purpose of making distribution decisions. Each trust would be modified to allow either the Distribution Trustee or the Independent Trustee to make the distribution decisions. The Distribution Trustee cannot be related or subordinate, or if related, no closer in relation than cousin to the current beneficiary, within the meaning of § 672(c). If the Distribution Trustee resigns or is replaced, the successor Distribution Trustee cannot be related or subordinate, or if related, no closer in relation than cousin to the current beneficiary, within the meaning of § 672(c). A cousin cannot serve as a

Distribution Trustee for a trust if the beneficiary is serving as the Distribution Trustee for the cousin's trust. The primary beneficiary, or if the primary beneficiary is deceased, a majority of the issue of the primary beneficiary, may replace any trustee. Any successor Independent Trustee must be a national banking association that has trust powers and aggregate capital and surplus of at least \$20 million. No child, issue or spouse may ever serve as his own trustee or co-trustee of the trust created for his benefit. The provisions regarding the Investment Trustee are not modified.

You have requested the following rulings:

1. The proposed modifications to Trust 1, Trust 2, and Trust 3 will not cause the interest of any beneficiary of Trust 1, Trust 2, and Trust 3 to be includible in such beneficiary's gross estate under §§ 2033, 2036, 2037, or 2038 of the Internal Revenue Code.
2. The proposed modifications to Trust 1, Trust 2, and Trust 3 will not cause Settlor to be treated as having, having exercised, or released a general power of appointment for purposes of §§ 2041 and 2514.
3. The proposed modifications to Trust 1, Trust 2, and Trust 3 will not cause the beneficiary of his respective trust, including any beneficiary serving as co-trustee, to be treated as having, having exercised, or released a general power of appointment for purposes of §§ 2041 and 2514.
4. The proposed modifications to Trust 1, Trust 2, and Trust 3 will not cause the trusts to lose their exempt status for purposes of the GST tax.

LAW AND ANALYSIS

Ruling 1

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037 provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), and the value of such reversionary interest immediately before the death of the decedent exceeds five percent of the value of such property.

Section 2038(a)(1) provides that the value of the decedent's gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the three-year period on the date of the decedent's death.

In this case, the proposed modifications to Trust 1, Trust 2, and Trust 3, as described above, are administrative in nature and do not cause the beneficiary's interest in his trust assets to be includible in the beneficiary's gross estate for purposes of § 2033. Further, the proposed modifications do not constitute a transfer within the meaning of §§ 2036 through 2038. Accordingly, based on the facts submitted and the representations made, we conclude that the proposed modifications to Trust 1, Trust 2, and Trust 3 will not cause the interest of any beneficiary of his trust to be includible in such beneficiary's gross estate under §§ 2033, 2036, 2037, or 2038.

Rulings 2 and 3

Section 2041(a)(2) provides that the value of the gross estate shall include the value of all property to the extent of any property with respect to which the decedent has, at the time of his death, a general power of appointment created after October 21, 1942, or with respect to which the decedent has at any time exercised or released a power of appointment by a disposition that is of such nature that if it were a transfer of property owned by the decedent the property would be includible in the decedent's gross estate under §§ 2035 to 2038, inclusive.

Section 2041(b)(1) provides that a general power of appointment is a power that is exercisable in favor of the decedent, the decedent's estate, the decedent's creditors,

or the creditors of the decedent's estate. However, a power to consume, invade, or appropriate property for the benefit of the decedent that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

Section 20.2041-1(b)(1) of the Estate Tax Regulations provides, in part, that a donee may have a power of appointment if he has the power remove or discharge a trustee and appoint himself. For example, if under the terms of the instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and the decedent has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, the decedent is considered as having a power of appointment. However, the mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of the fiduciary duties is not a power of appointment.

Section 2514(b) provides that the exercise or release of a general power of appointment created after October 21, 1942, shall be deemed a transfer of property by the individual possessing such power.

Section 2514(c) provides that a general power of appointment is a power that is exercisable in favor of the individual possessing the power (the possessor), his estate, his creditors, or the creditors of his estate. However, a power to consume, invade, or appropriate property for the benefit of the possessor that is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment.

Section 25.2514-1(b)(1) of the Gift Tax Regulations provides, in part, that a donee may have a power of appointment if he has the power remove or discharge a trustee and appoint himself. For example, if under the terms of the instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and A has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, A is considered as having a power of appointment. However, the mere power of management, investment, custody of assets, or the power to allocate receipts and disbursements as between income and principal, exercisable in a fiduciary capacity, whereby the holder has no power to enlarge or shift any of the beneficial interests therein except as an incidental consequence of the discharge of the fiduciary duties is not a power of appointment.

In Rev. Rul. 95-58, 1995-2 C.B. 191, the Service ruled that a decedent/grantor's reservation of an unqualified power to remove a trustee and to appoint an individual or

corporate successor trustee that is not related or subordinate to the decedent within the meaning of § 672(c), is not considered a reservation of the trustee's discretionary powers of distribution over the property transferred by the decedent/grantor to the trust. Accordingly, the trust corpus is not included in the decedent's gross estate under § 2036 or 2038.

Section 672(c) defines the term "related or subordinate party" to mean any nonadverse party who is (1) the grantor's spouse if living with the grantor; or (2) any one of the following: the grantor's father, mother, issue, brother or sister; an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

In this case, after the proposed modifications, the primary beneficiary, or if the primary beneficiary is deceased, a majority of the issue of the primary beneficiary will have the power to remove and replace any trustee. This power is equivalent to the power referenced in Rev. Rul. 95-58 where a replacement trustee may not be related or subordinate to the powerholder within the meaning of § 672(c). Settlor did not and does not as a result of the proposed modifications have a power to remove or replace the trustees of the trust. Further, the Independent Trustee, the Distribution Trustee, and their successors cannot be related or subordinate, or if related, no closer than cousin to the current beneficiary, within the meaning of § 672(c). Accordingly, based on the facts submitted and the representations made, we conclude that the proposed changes to Trust 1, Trust 2, and Trust 3 will not cause Settlor to be treated as having, having exercised or released a general power of appointment for purposes of §§ 2041 and 2514. We further conclude that the proposed changes to Trust 1, Trust 2, and Trust 3 will not cause the beneficiary of Trust 1, Trust 2, and Trust 3, including any beneficiary serving as co-trustee, to be treated as having, having exercised or released a general power of appointment for purposes of §§ 2041 and 2514.

Ruling 4

Section 2601 imposes a tax on every GST made after October 26, 1986. A GST is defined under § 2611(a) as (1) a taxable distribution, (2) a taxable termination, and (3) a direct skip.

Section 2612(a) provides that the term "taxable termination" means a termination (by death, lapse of time, release of a power, or otherwise) of an interest in property held in a trust unless (A) immediately after such termination, a non-skip person has an interest in such property, or (B) at no time after such termination may a distribution (including distributions on termination) be made from such trust to a skip person.

Section 2612(b) provides that the term “taxable distribution” means any distribution from a trust to a skip person (other than a taxable termination or a direct skip).

Under § 2612(c)(1), a direct skip is a transfer subject to federal estate or gift tax of an interest in property to a skip person.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the GST Tax Regulations, the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), the GST tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that such transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added). Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the settlor had a power that would have caused inclusion of the trust in his or her gross estate under § 2038 or 2042, if the settlor had died on September 25, 1985.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under paragraph (b)(1), (2), or (3) of this section (hereinafter referred to as an exempt trust) will not cause the trust to lose its exempt status. In general, unless specifically provided otherwise, the rules contained in this paragraph are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Thus (unless specifically noted), the rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust (including a trustee distribution, settlement, or construction that does not satisfy paragraph (b)(4)(i)(A), (B), or (C) of this section) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Section 26.2601-1(b)(4)(i)(D)(2) provides that for purposes of this section, a modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. To determine whether a

modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. A modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust.

In § 26.2601-1(b)(4)(i)(E), Example 10 considers the following situation. In 1980, Grantor established an irrevocable trust for the benefit of Grantor's issue, naming a bank and five other individuals as trustees. In 2002, the appropriate local court approves a modification of the trust that decreases the number of trustees which results in lower administrative costs. The modification pertains to the administration of the trust and does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification. In addition, the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the trust will not be subject to the provisions of chapter 13.

In this case, the proposed modifications to Trust 1, Trust 2, and Trust 3, as described above, are all changes that are administrative in nature under § 26.2601-1(b)(4)(i)(D)(2), and will not be considered to shift a beneficial interest to a lower generation in the trust. See Example 10 of § 26.2601-1(b)(4)(i)(E). The changes will not result in a shift in any beneficial interest to a lower generation nor do the changes extend the time for vesting of any beneficial interest in Trust. Accordingly, based upon the facts submitted and the representations made, we conclude that the proposed modifications to Trust 1, Trust 2, and Trust 3 will not cause Trust 1, Trust 2, or Trust 3 to lose its exempt status from GST tax.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the

material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy for § 6110 purposes
Copy of this letter